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SIPDIS

USTR FOR CRONIN  
NSC FOR DEMPSEY  
USDOC FOR 3134/USFCS/OIO/WH/EOLSON  
USDOC ALSO FOR 4332/ITA/MAC/WH/OLAC/MWARD  
USDOC ALSO FOR 4110/ITA/TRADE AND COMPLIANCE/LRIGOLI/NBOLIN

SENSITIVE

E.O. 12958: N/A  
TAGS: ETRD EFIN EINV ETRD PREL PGOV BR  
SUBJECT: ZERO SATISFACTION FROM GOB ON SODA-ASH TAX ISSUE

SUMMARY

¶1. (SBU) On August 18, Itamaraty officials presented us their official finding that the Rio state tax policy with regard to soda ash produced by local enterprise ALCALIS does not illegally discriminate against U.S. soda ash producers/exporters. Our own scrutiny of the text of the 2001 Rio State decree cited by the Brazilians as the base of their 'finding' makes their argument transparently inaccurate. From our own tentative computations, it would seem the volume of potential U.S. soda-ash export sales affected may have been of the order of USD 20 million in 2003, when U.S. sales to Rio were approximately eight million dollars out of gross U.S. export sales to Brazil of over forty million dollars (the rest being to states other than Rio). Having regularly re-addressed the GoB on this concern in the more than two years since it first arose, only to arrive at such a GoB assertion now, Embassy has no expectation of achieving results via further approaches to Itamaraty. Text of the Rio State decree in the original Portuguese and rough Embassy translation included in Paras 10-11 below. Para 9 contains data about the current status of Brazil's soda-ash market, including U.S. market share.  
END SUMMARY.

¶2. (U) On August 18, EconCouns, Trade Officer and DSCO met with Director-General of the Economic Department Minister Piragibe Tarrago and other Itamaraty (Ministry of Foreign Affairs) specialists again to discuss the soda-ash issue, among other subjects. This was the fourth meeting Emboffs have held with senior-level Itamaraty interlocutors over the last year to request an official response to the USG concern that the Rio state ICMS tax treatment of domestic and imported soda ash involves a national-treatment breach under GATT Article III, in addition to occasions on which the issue has been raised by, e.g., visiting USDOC A/S Lash and D/USTR Allgeier.

¶3. (U) Minister Tarrago informed Emboffs that the MFA had definitively clarified the Rio ICMS issue in meetings with CAMEX and the Rio State Finance Ministry. He asserted categorically that Rio state taxes both domestically-produced and imported soda ash at the same ICMS rate, currently 19%. Tarrago proceeded to note that under the ICMS tax regime purchasers of a product may request a rebate or credit of the ICMS paid on the input (e.g., soda ash), from the state tax authority upon sale of their final product; this credit/rebate is likewise available regardless of whether the soda ash is imported or domestic. Pressed on how it might be documented that ALCALIS in fact is subject to, and pays, the same 19% ICMS on its production as U.S. soda-ash exporters on their sales, he noted that ALCALIS is entitled to consider its financial-transaction data proprietary and not divulge it, but he remarked that the fact could likely be verified by contacting local soda-ash customers.

¶4. (U) Tarrago went on to suggest that confusion over the soda-ash ICMS status might have arisen because of the fact that Rio state allows ALCALIS the option of paying a flat 2% tax rate on its gross revenue. This is totally separate from ICMS tax-regime considerations, he told us. The basis for Rio allowing this option is that ALCALIS produces salt, an item within the Brazilian "cesta basica (basic basket)" of fundamental food items. Under Rio state rules, allegedly, companies that produce any such items, as whole or part of their production, may choose either to have their gross revenue taxed at a flat 2% rate, or submit themselves to a normal state corporate tax regime, which, depending on various credits or rebates may or may not result in a higher taxation rate.

¶5. (U) Thus, the soda-ash tax issue essentially is a domestic-tax-regime matter, concluded Tarrago. The specifics are outlined in Rio State Decree 28104 of April

13, 2001, articles 36-38, and 40. Tarrago also singled out Article 40 of this decree as containing, in his words (seconded by one of the Itamaraty specialists also present) a general statement that it shall not affect the general application of the tax regime, guaranteeing equal application of the ICMS tax for domestic producers and importers.

16. (SBU) The Brazilians did not have the text of the 2001 Rio decree at hand; we thus could not go over it jointly at the August 18 meeting. We ourselves have since re-scrutinized the same elements of the decree's text cited by the Brazilians as the basis of their finding. That text does not in reality give any basis for the latter. Totally the contrary, and unambiguously so, we judge: the evidence *prima facie* does point to a national-treatment issue. In particular:

-- The decree does deal directly with the ICMS regime; the 2% tax rate is not at all an unrelated, separate tax issue.

-- The 2% tax rate on gross revenue ("receita bruta auferida") for all operations is indeed offered as an alternative to paying the regular 19% ICMS; and this alternative is made available to companies which refine salt for consumption and, very specifically, producers of soda ash that also market salt (Article 38), but not to the importer of U.S. soda ash.

-- Article 40, which the Brazilians cited as proving that the regular application of the ICMS is not affected, actually seems to require only that the fiscal documents of taxpayers under this special regime must continue to conform to normal ICMS regulations. It does not state or mean that the 19% ICMS tax rate continues to apply.

-- Indeed, Article 42 appears to assume that covered taxpayers will use the 2% of gross revenue tax, not the 19% ICMS. They actually have to request an opt-out from the State NOT to do so. Whether particular companies choose to opt-out or not, presumably this different tax regime is at times beneficial -- i.e., gives the option to pay less tax than under a 19% ICMS.

17. (SBU) Embassy Trade Officer subsequently presented these considerations over lunch with Tarrago's Market Access Division subordinate Maria Elisa Maia and her deputy, Felipe Bandeira de Mello. The latter made three defenses of the special tax regime. First, they argued that since use of the 2% tax regime is optional, it does not necessarily contravene GATT Article III, and further, it is an open question as to whether or not the company has actually used the special regime to lower its tax liability. We counter-argued that, whether or not the company has taken advantage of the special regime, providing an opportunity to preferentially lower the domestic company's tax liability could be inconsistent with Article III.

18. (SBU) Second, the Brazilians claimed that statistics showing stable then increasing U.S. exports of soda ash to the State of Rio since 2001 confirms that U.S. exporters were not prejudiced. We argued that this is inconclusive, since U.S. exports theoretically could have reached higher levels still except for the domestic producer's potentially enhanced competitiveness due to the tax break. Finally, the Brazilians opined that, even if the domestic producer lowered its tax liability using the special regime, the stable market shares for the domestic producer and the importer in the sale of soda ash in Brazil since 2001 illustrates that the importer has not been prejudiced, since the domestic producer appears not to have lowered its price to gain market share. We rejoined that what the domestic producer chooses to do with the tax windfall - increase profit or lower prices - is immaterial.

19. (SBU) Mission's research and input from FCS Rio industry contacts indicates the following as to the current state of Brazil's soda-ash market. According to ANSAC's Rio-based agent, with whom FCS Rio met on May 24, the total Brazilian market for soda ash is 650,000 Metric Tons/Year. ALCALIS, the Brazilian producer, produces 165,000 MT/Y or 25%. The balance of Brazil's needs is imported from:

-- ANSAC (U.S.): 300,000 MT/Y. This means ANSAC has 45% of the Brazilian market and is responsible for 70% of all Brazilian imports of soda ash.

-- SOLVAY (Belgium): 130,000 MT or 20% of Brazil's imports. The ANSAC Rio agent noted to us that SOLVAY, although a Belgian group, has plants in the U.S. and is a member of ANSAC.

-- CHINA: 65,000, or 10% of the Brazilian market.

Preliminary Embassy research of Brazilian government trade figures indicates the following with regard to U.S. soda-ash

sales to Brazil:

-- U.S. exporters' market share has been stable since 1999: 64%, 64%, 60%, 65% in 2000, 2001, 2002, 2003, respectively. For the January-July period the figures for 2003 and 2004 were 67% and 66%.

-- The percentage of Brazil's total soda-ash imports that are bought in Rio state has been constant at roughly one-fifth since 1998, although for January-June in 2004 the ratio dropped to 14%, compared to 16% for the same period in 2003.

-- U.S. exporters' market share in the Rio state local market has been 97% to 99% for every year since 1998, but the January-June figure for 2004 indicates a drop, to 81.6% compared to 96% for the same period in 2003.

COMMENT: Apparently some two-thirds of Brazil's total soda-ash market is outside Rio state, mainly in Sao Paulo. The U.S. exporter has had a long-term monopoly of export sales into Rio state, something over 60,000 tons in 2003, according to the GOB figures. This compares to the ALCALIS production there of 165,000 tons, with Chinese and Belgian competitors evidently not even on the scene. We do not know if ALCALIS's entire production is sold and consumed in Rio state itself, as seems logical, or if some is sold to customers in other Brazilian states. In any case, depending on the degree of advantage the Rio 2% tax favor gives ALCALIS in selling its output, it would seem that sales of up to that entire output could theoretically be affected.

END COMMENT.

ALCALIS (located in Arraial do Cabo municipality about three hours east of Rio de Janeiro city that is said to have gained independent administrative status solely because of the presence of the mega-plant itself), currently has a reported 700 employees, down from the two-thousand range in the past. It is said to be facing irredeemable problems, including the failure of its buyers when it was privatized in the mid-1990s to be current with their payments, and environmental issues.

#### 110. (U) TEXT OF RIO STATE DECREE 28104 OF APRIL 13, 2001:

DECRETO No. 28.104 DE 10 DE ABRIL DE 2001

Altera o Titulo VI, do Livro V, do Regulamento do ICMS, aprovado pelo Decreto n 27.427/2000.

O GOVERNADOR DO ESTADO DO RIO DE JANEIRO, no uso de atribuicoes constitucionais,

DECRETA:

Art. 1. O Titulo VI, do Livro V, do Regulamento do ICMS, aprovado pelo Decreto no. 27.427, de 17 de novembro de 2000, passa a vigorar com a seguinte redacao:

#### TITULO VI

##### DAS ATIVIDADES INDUSTRIALIS DE REFINO DE SAL PARA ALIMENTACAO E DE PRODUCAO DE CARBONATO DE SODIO

"Art. 36. O contribuinte do ICMS que exerce exclusivamente atividade industrial de refino de sal para alimentacao, classificada no subgrupamento denominado "refino de sal para alimentacao", codigo 4.24.12.05-8, do Catalogo de Atividades Economicas, deve calcular o valor do ICMS devido a cada mes pela aplicacao direta do percentual de 2% (dois por cento) sobre a receita bruta auferida no periodo, acrescida dos valores referentes as operacoes de transferencia, excluidos os valores referentes as operacoes sujeitas ao regime de substituicao tributaria.

Paragrafo unico - Para os efeitos deste artigo, considera-se receita bruta o produto da venda de bens e servicos nas operacoes de conta propria, o preco dos servicos prestados e o resultado auferido nas operacoes por conta alheia, nao incluido o Imposto sobre Produtos Industrializados (IPI), as vendas canceladas e os descontos incondicionais concedidos.

Art. 37. O imposto incidente sobre o fornecimento de gas natural, utilizado no processo produtivo das industrias a que se refere o artigo anterior, fica diferido para o momento em que ocorrer a saida do produto resultante do processo de industrializacao.

Paragraph 1. O imposto diferido nos termos deste artigo considera-se incluido na estimativa de que trata o artigo anterior.

Paragraph 2. A empresa que efetuar o fornecimento de gas para os contribuintes a que se refere o artigo anterior devera excluir do valor da operacao a parcela referente ao imposto diferido.

Art. 38. As disposicoes dos artigos 36 e 37 tambem se aplicam ao contribuinte que, cumulativamente com a atividade economica mencionada no caput do artigo 36, seja produtor de carbonato de sodio (barrilha) e comercialize sal, salmoura e demais mercadorias do genero.

Paragrafo unico - Na hipotese deste artigo, o deferimento de que trata o artigo 37 tambem se estendera, nas mesmas condicoes nele estabelecidas para o fornecimento de gas natural, ao fornecimento de energia eletrica e a saida de calcario.

Art. 39. O procedimento nos termos dos artigos 36 a 38 veda o aproveitamento de quaisquer creditos do imposto.

Art. 40. Os documentos fiscais referentes as operacoes realizadas pelos contribuintes a que se refere este Titulo serao emitidos segundo as regras comuns de tributacao, inclusive no que se refere ao destaque do imposto, que podera ser creditado pelo destinatario, na forma da legislacao.

Art. 41. Estara automaticamente excluido do regime de tributacao previsto neste Decreto o contribuinte que nao estiver em dia com suas obrigacoes tributarias, ressalvadas as hipoteses de suspensao da exigibilidade do credito tributario, nos termos do artigo 151, doCodigo Tributario Nacional.

Paragrafo unico - Na hipotese deste artigo, o contribuinte devera apurar a diferenca entre o ICMS calculado nos termos deste Decreto e o apurado segundo as regras comuns de tributacao, com os acrescimos legais, e, se for o caso, recolher a diferenca.

Art. 42. O contribuinte pode optar por permanecer no regime normal de apuracao do ICMS, desde que expressamente o requeira, na forma que dispuser a Secretaria de Estado de Fazenda e Controle Geral."

Art. 2. Este Decreto entra em vigor na data de sua publicacao, revogadas as disposicoes em contrario.  
Rio de Janeiro, 10 de abril de 2001

ANTHONY GAROTINHO  
Governador

**11. (U) (UNOFFICIAL EMBASSY TRANSLATION)**

Decree No. 28.104, April 10, 2001

Alters Title VI of Book V of the Regulation of ICMS, approved by Decree No. 27.427/2000

The Governor of the State of Rio de Janeiro, using constitutional powers,

Decrees:

Art. 1 of Title VI of Book V of the Regulation of ICMS, approved by Decree No. 27.427, November 17, 2000, enters into force with the following revisions:

**Title VI**

**ON THE INDUSTRIAL ACTIVITIES OF REFINING SALT FOR CONSUMPTION AND OF PRODUCING SODA ASH**

"Art. 36. The ICMS taxpayer that exercises exclusively the industrial activity of refining salt for consumption, classified on the subgroup denominated by "refining of salt for consumption," code 4.24.12.05-8, of the Catalog of Economic Activities, ought to calculate the ICMS value owed each month by applying directly a percentage of 2 % (two per cent) to the gross revenues derived in the period, increased by the values relating to transfer operations, excluding the values relating to operations subject to the tax substitution regime.

Sole Paragraph - For the purpose of this article, consider gross revenues the product of sales of goods and services in these operations, the price of services rendered and the result derived in other operations, not including the Industrialized Products Tax (IPI), cancelled sales, and unconditional discounts provided.

Art. 37. The incident tax for the supply of natural gas, utilized in the productive process of industries that are the subject of the previous article, are deferred until the moment in the relevant product leaves the production process.

Paragraph 1. The tax deferred under the terms of this article is considered within the estimate that is dealt with in the previous article.

Paragraph 2. The company that provides the gas to taxpayers that are the subject of the previous article ought to exclude, out of the operations value, the installment relating to the deferred tax.

Art. 38. The provisions of articles 36 and 37 also apply to the taxpayer who, in addition to the economic activity mentioned in article 36, produces soda ash and markets salt, brine and other commodities of this nature.

Sole Paragraph - In considering this article, the deferment that is dealt with in Article 37 also will extend, under the same conditions as those established for the supply of natural gas, to the supplier of electric energy and to the supplier of limestone.

Art. 39. The procedure in terms of Articles 36 to 38 prohibits the use of whatever credit of this tax.

Art. 40. The fiscal documents relating to the operations performed by taxpayers to which this Title refers are to be issued according to common tax rules, including those detailing the tax that can be credited by the purchaser, in conformance with legislation.

Art. 41. A taxpayer who is delinquent with his tax obligations will be automatically excluded from the tax regime provided in this decree, except in the case of suspension of tax credit requirements, in accordance with Article 151 of the National Tax Code.

Sole Paragraph - In interpreting this article, the taxpayer ought to calculate the difference between the ICMS calculated under the terms of this Decree and that according to common tax rules, with legal charges, and as necessary, pay the difference.

Art. 42. The taxpayer can opt to continue in the normal regime for ICMS collection, making an express request, in the form determined by the State Secretary of Finance and Comptroller General.

Art. 43. This Decree enters into force on the date of its publication, provisions to the contrary hereby being revoked.

Rio de Janeiro, 10 April 2001

Anthony Garotinho  
Governor

(End Unofficial Embassy Translation)

DANILOVICH